

BEFORE THE  
POSTAL REGULATORY COMMISSION  
WASHINGTON, D.C. 20268-0001

PERIODIC REPORTING  
(UPS PROPOSAL ONE)

Docket No. RM2020-9

**INITIAL COMMENTS OF THE UNITED STATES POSTAL SERVICE  
ON UPS PROPOSAL ONE**  
(December 15, 2020)

On May 29, 2020, United Parcel Service, (UPS) sought initiation of this proceeding by filing a petition to consider a proposal it wished to make regarding postal costing methodologies. In Order No. 5586 (Jul. 13, 2020), the Commission announced an intent to proceed with Proposal One. Order No. 5738 (Oct. 27, 2020) set December 15, 2020 as the deadline for initial comments on Proposal One. The Postal Service hereby provides its initial comments on that proposal.

**A. Introduction**

The petition begins with the unremarkable observation that the Postal Service experiences a seasonal peak in volume and cost at the end of the calendar year.<sup>1</sup> If the intended implication is that the Postal Service and the Commission have not properly contemplated this fact, it is unfounded. The Postal Service is well aware of this volume peak, plans for it annually, has analyzed its cost implications, and will continue to do so. The petition goes on to present a distinctly one-sided description of the seasonal peak

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<sup>1</sup> See, Petition of United Parcel Service, Inc. For the Initiation of Proceedings to Make Changes to Postal Service Costing Methodologies, (UPS Petition), Docket No. RM2020-9, May 29, 2020, at 6.

and its implications, eventually reaching the erroneous conclusion that all seasonal peak costs should be allocated to competitive products. In doing so, the petition relies on distorted, *ad hoc* costing structures, and ignores or downplays longstanding efforts by the Postal Service and the Commission to appropriately address seasonal costs.

The Postal Service acknowledges that the existence of a seasonal peak in volume can cause seasonal costs and agrees with UPS that package volumes are an important part of that peak. The Postal Service has performed, and will continue to perform, appropriate costing exercises to ensure that package volumes bear the seasonal peak costs that they cause. But those costing exercises should be grounded in both solid economic theory and actual operational practice. As shown below, the petition lacks both, and should therefore be rejected.

**B. UPS presents a distorted description of the seasonal peak and its implications. This includes a series of misstatements about seasonal costs and a flawed approach to measuring them.**

1. UPS's selective presentation of seasonal peak costs over-emphasizes the size of the peak and suggests costing problems where they do not exist.

Both the Postal Service and the Commission have been long aware of the seasonal peak in certain Postal Service volumes and costs, and as that peak has become larger for competitive products, the Postal Service has refined its cost models to accurately account for peak costs. Just as it is incorrect to deny the existence of a seasonal peak, it is also incorrect to overstate its importance and implications. This is essentially what the petition does.

For example, UPS emphasizes the size of seasonal overtime costs, particularly for city and rural carriers, suggesting that they represent a major increase in costs.<sup>2</sup> While it is true that carrier overtime costs are higher in December than any other month, December overtime costs represent a very small percentage of annual carrier labor costs, making up just two percent of city carrier costs and just one percent of rural carrier costs. This is shown in Table 1, which presents the total overtime costs for city and rural carriers in Fiscal Year 2020 (December 2019) along with the annual carrier labor costs for the same fiscal year.<sup>3</sup>

Table 1  
Carrier December Overtime Costs Relative to Annual Costs (Fiscal Year 2020)

Carrier Type	December Overtime Cost (Thousands)	Annual Labor Cost (Thousands)	% December Overtime Cost
City Carriers	\$348,389	\$17,294,716	2.0%
Rural Carriers	\$89,173	\$8,217,641	1.1%

The Postal Service incurs overtime costs for carriers in all months throughout the year, and while city and rural overtime costs do increase in December, the increase is not dramatic. This is demonstrated in Figure 1, which presents FY2020 city carrier costs by month, separated by regular time costs and overtime costs.<sup>4</sup> The figure shows

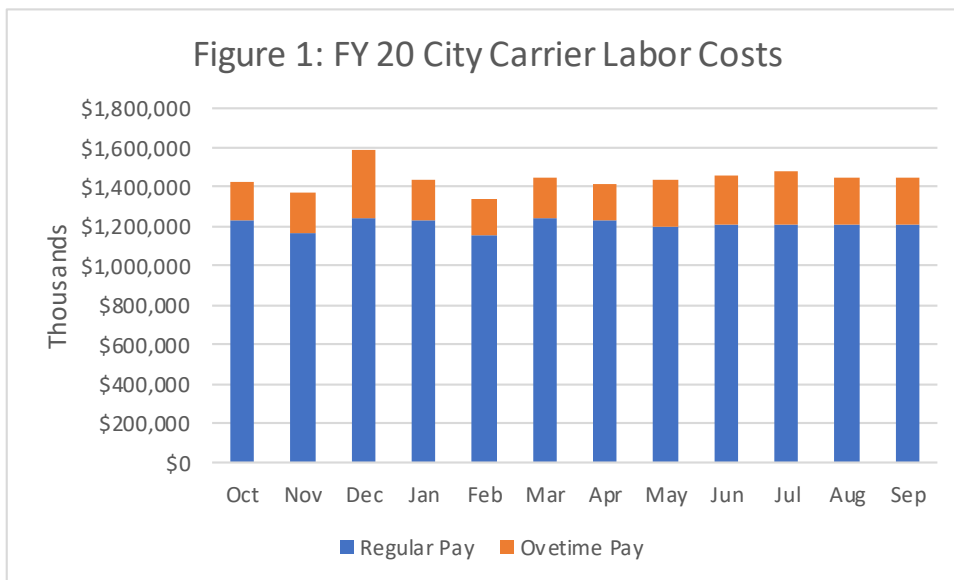
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<sup>2</sup> Id. at 7.

<sup>3</sup> The complete set of FY 2020 monthly regular and overtime costs for city and rural carriers are presented in Folder USPS-RM2020-9-1.

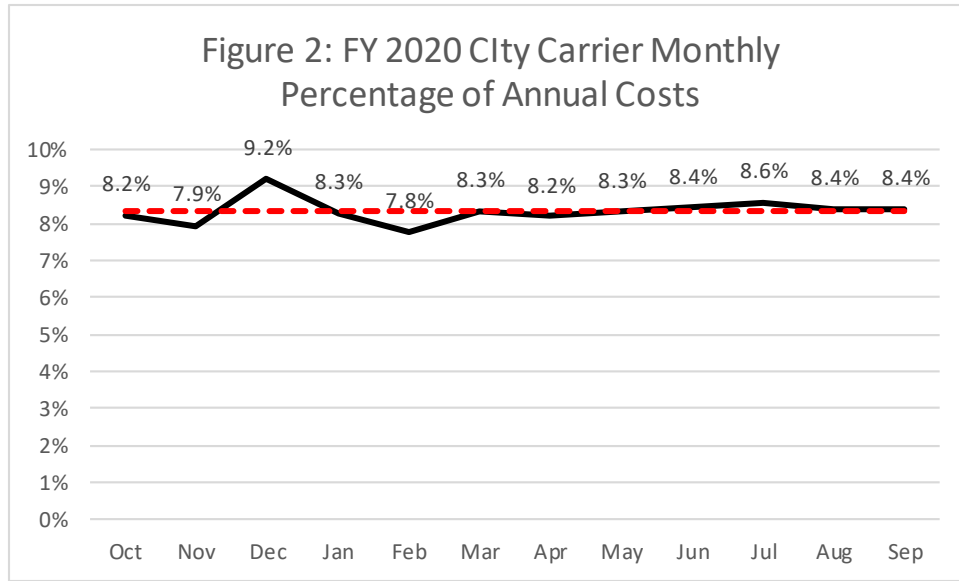
<sup>4</sup> The city carrier labor cost data that underlie Figure 1 are presented in Folder USPS-RM2020-9-1.

a modest increase in city carrier cost for December, representing a modest seasonal peak.



The relative size of the December seasonal peak for city carrier costs can be evaluated by comparing the proportion of costs incurred in December with the proportions incurred in other months. If there were no variation in city carrier costs across months, then each month would incur one-twelfth, or 8.3 percent, of the annual cost. The city carrier monthly cost percentages are presented in Figure 2 along with a baseline of equal 8.3 percentages.<sup>5</sup> The figure shows that December (including overtime) represents 9.2 percent of annual costs, which is just modestly above the baseline percentage. The figure confirms that the seasonal peak in city carrier costs is modest.

<sup>5</sup> The calculation of the monthly city carrier cost percentages is presented in Folder USPS-RM2020-9-1.



One important reason that the seasonal carrier cost peak is not larger is the fact that hourly labor costs do not increase during the peak:<sup>6</sup>

The Postal Service examined the changes throughout FY 2020 in labor cost per hour (including overtime costs) by comparing average labor cost per hour across months, with and without overtime, from the National Payroll Hours Summary Reports. For each month, one two-week pay period completely contained within the month was selected as representative for that month. As Figure 1 demonstrates, the relative labor costs per hour between full-time city carriers and part-time city carriers (represented by City Carrier Assistances, CCAs) are stable throughout the year, including during the peak season.

This result occurs in part because benefit costs do not accrue at the same rate for overtime hours as they do for regular hours and because, as explained above,

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<sup>6</sup> See, Response of The United States Postal Service to Order No. 5697 Regarding Overtime Costs, Docket No. RM2020-10, Nov. 24, 2020, at 1-2.

overtime hours occur throughout the year. As a result, hourly labor costs do not climb during the seasonal peak:<sup>7</sup>

The relatively stable trend in overall labor costs (including overtime costs) reveals that the overtime costs alone do not materially impact the labor costs accrued by any craft. Overtime costs per hour, relative to wages and other labor-related costs, are not disproportionately large for any month, including December, and so do not contribute to unusually high labor costs per hour in any particular month.

UPS also emphasizes the seasonal increases in Special Purpose Route costs and purchased highway transportation costs.<sup>8</sup> The Commission is already aware of this, as the Postal Service costing model includes separate accounts and separate analyses for both of these types of costs. The Postal Service has collected separate seasonal data for Special Purpose Route costs and pursued a separate analysis of seasonal attributable costs.<sup>9</sup> This analysis included not only the seasonal increase in cost at established SPR units, but also the temporary use of SPR hours to assist in package delivery in non-SPR unit delivery areas.<sup>10</sup> The analysis included investigation of the type of mail delivered in December and wages paid to those carrier doing SPR deliveries.<sup>11</sup> In sum, the existence of higher SPR costs for the December peak raises

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<sup>7</sup> Id. at 2

<sup>8</sup> See, UPS Petition, Docket No. RM2020-9, May 29, 2020, at 11-12.

<sup>9</sup> See Docket No. RM2019-6, A New Study of Special Purpose Route Carrier Costs, Professor Michael D. Bradley, June 21, 2019 at 66.

<sup>10</sup> Id. at 32, footnote 10.

<sup>11</sup> Id. at 78.

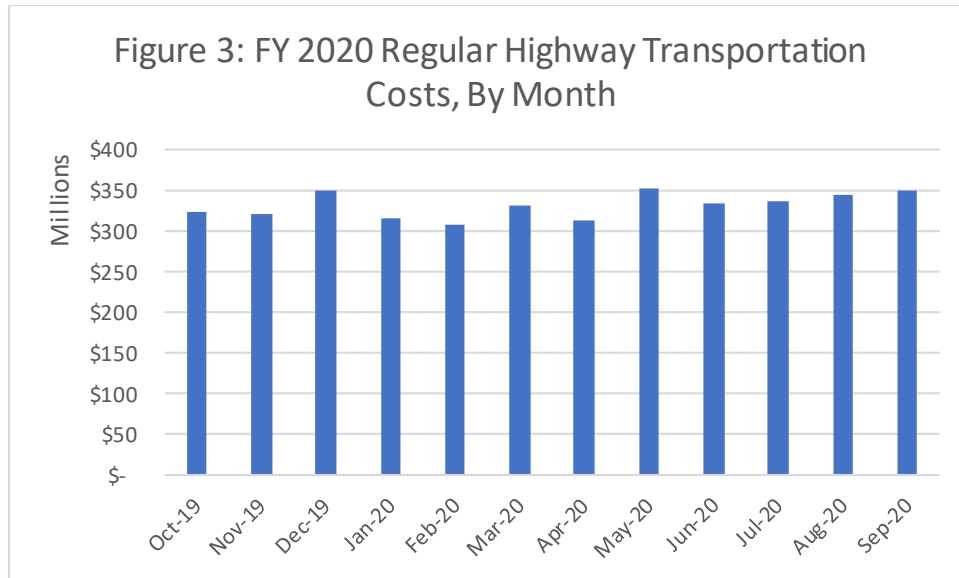
no latent issues for cost attribution, as they have been effectively studied and incorporated into product costs.

The petition's emphasis on highway transportation costs during the peak is also misleading.<sup>12</sup> The presentation of total highway transportation cost omits the key fact that the Postal Service records seasonal highway transportation costs in separate accounts. Those accounts are analyzed separately from the regular purchased highway transportation accounts, and when they are removed from total purchased highway transportation costs, the seasonal pattern in cost disappears. This is demonstrated in Figure 3, which presents the accrued transportation costs, by month, in the regular transportation accounts, which exclude the costs for the Christmas and Dynamic Route Optimization (DRO) accounts.<sup>13</sup> Not only is there no seasonal peak, but also December is not even the highest cost month. That honor falls to May. The Postal Service explicitly and separately analyzes those accounts that include seasonal purchased highway transportation costs, and the remaining costs show no seasonal pattern.

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<sup>12</sup> Peak air transportation costs are not at issue because, within the established model, they are completely attributed to products.

<sup>13</sup> The highway transportation cost data that underlie Figure 3 are presented in Folder USPS-RM2020-9-1.



2. UPS presents an incomplete view of the seasonal volume peak that erroneously focuses solely on competitive products.

The Postal Service faces several volume peaks, as different postal products have different seasonal patterns. For example, Marketing Mail peaks in November, as part of the fall mailing season. Several products, including First-Class Mail, a number of domestic competitive products, and international mail have seasonal peaks at the end of the calendar year. Yet, UPS's presentation of the December volume peak misses these important facts, resulting in it mistakenly pinning the volume peak solely on competitive products.<sup>14</sup>

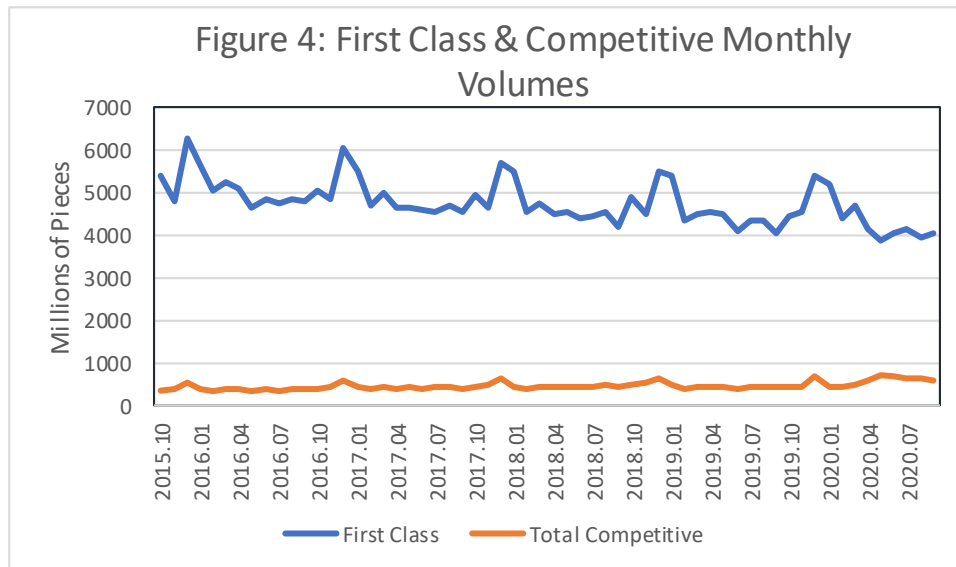
Figure 4 presents the monthly volumes for First-Class Mail and the group of domestic competitive products for the past five fiscal years.<sup>15</sup> The figure reveals the well-known downward trend in First-Class Mail volume and shows that, despite this

<sup>14</sup> See, UPS Petition, Docket No. RM2020-9, May 29, 2020, at 14.

<sup>15</sup> The volume data that underlie Figure 4 are presented in Folder USPS-RM2020-9-1.



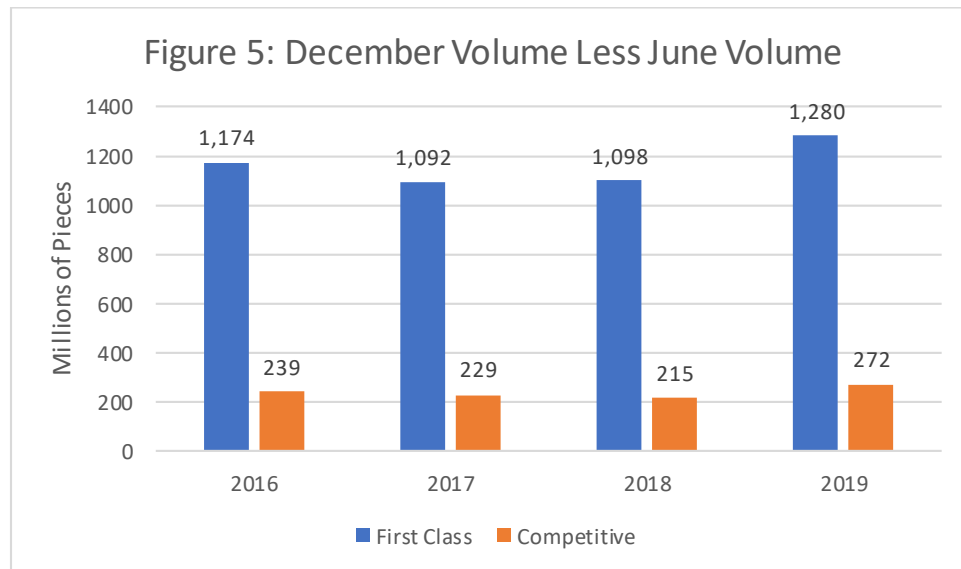
decline, First-Class Mail volumes remain an order of magnitude larger than competitive volumes. It also shows that the First-Class Mail volume peak is still much larger than the competitive volume peak.



The relative sizes of the two peak volumes are presented in Figure 5, which shows the difference between the December volumes and June volumes for the last four complete calendar years.<sup>16</sup> The figure shows that the First-Class Mail volume peak is many times larger than the competitive volume peak. This is not to suggest that the competitive volume peak is not important for increasing costs during the peak season. Competitive products are more expensive to handle, on a unit basis, than First-Class Mail products, so the competitive volume impact on seasonal cost will be larger than Figure 5 suggests. But the figure does effectively refute the claim that the seasonal peak is *solely* caused by competitive products. Clearly, both First-Class Mail and

<sup>16</sup> The volume change calculations for Figure 5 are presented in Folder USPS-RM2020-9-1.

competitive products contribute to the end-of-year peak. This is reflected by the fact that Postal Service operations experts plan the seasonal response based upon expected volumes of both First-Class Mail and competitive products.



The petition obscures this obvious point in three ways. First, it improperly adds non-peak volumes for Marketing Mail to the peak-volume for First-Class Mail, thus hiding the First-Class Mail volume peak.<sup>17</sup> It is well known that Marketing Mail has its annual peak in November and then returns to a normal level in December, so Marketing Mail necessarily has a volume decline in December. The fact that Marketing Mail returns to a non-peak volume in December does not preclude the Postal Service from experiencing a First-Class Mail volume peak in December that requires the Postal Service to expend resources to handle it. First-Class Mail and Marketing Mail are not perfect substitutes in how they are handled by the Postal Service. For example,

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<sup>17</sup> See, UPS Petition, Docket No. RM2020-9, May 29, 2020, at 17.

Marketing Mail is entered deeper in the Postal Service network than is First-Class Mail and has a more flexible delivery commitment.

Next, UPS converts actual volumes to index numbers in order to calculate percentage changes in volumes rather than actual volumes.<sup>18</sup> This provides a misleading sense of the relative sizes of the seasonal volume peaks. When time series are of disparate size, one can separately relate each one to its own base, translating absolute changes into percentage changes. But one must be careful pursuing this approach because small volumes can have large percentage changes.

UPS argues that domestic competitive products are the cause of the end-of-year volume peak because they have a larger percentage increase from November to December than does First-Class Mail. But by UPS's own standard, this inference is incorrect because, as shown in Table 2, on average, international mail has a larger percentage increase from November to December than does competitive mail.<sup>19</sup> Based upon percentage increases, international mail would be the cause of the December peak, even though its December 2019 volume was just 100.8 million pieces, far smaller than the volume of either competitive products or First-Class Mail. This outcome demonstrates that when assessing the relative impact of different seasonal volumes on Postal Service costs, the index approach is misleading.

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<sup>18</sup> Id. at 18.

<sup>19</sup> The calculations producing these volume changes are presented in Folder USPS-RM2020-9-1.

Table 2

November to December Percentage Volume Changes

<b>Fiscal Year</b>	<b>First Class</b>	<b>Competitive</b>	<b>International</b>
2016	30.8%	47.9%	56.7%
2017	25.2%	40.1%	71.2%
2018	22.1%	29.2%	22.6%
2019	21.8%	24.2%	31.8%
2020	18.8%	47.3%	40.5%
<b>Average</b>	<b>23.7%</b>	<b>37.7%</b>	<b>44.6%</b>

Finally, UPS argues that the seasonal changes in cost are correlated with the seasonal changes in competitive volumes.<sup>20</sup> While a correlation between monthly changes in competitive volume and monthly changes in city carrier cost does exist, so does a correlation between monthly changes in First-Class Mail volume and monthly changes in city carrier costs. The result, shown in Table 3, again confirms that both First-Class Mail and competitive products contribute to the seasonal peak.<sup>21</sup>

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<sup>20</sup> See, UPS Petition, Docket No. RM2020-9, May 29, 2020, at 14

<sup>21</sup> The program that calculates these correlations is presented in Folder USPS-RM2020-9-1.

Table 3  
Correlation Between Changes in Volume and  
Changes in Carrier Cost

Product Group	Correlation	P-Value
First Class	0.8342	<.0001
Competitive	0.8568	<.0001

**C. UPS’s analysis of “unexplained” seasonal costs is *ad hoc*, has no theoretical or operational basis, and is fatally flawed.**

The UPS petition asserts that there are large amounts of “unexplained” December costs that must necessarily be linked to the seasonal peak in the volume of competitive products.<sup>22</sup> In particular, UPS claims that hundreds of millions of dollars of December accrued costs should be attributed to the incremental cost of competitive products because, in UPS’s view, these costs are “unexplained” by the established costing methodology and are solely caused by competitive products.<sup>23</sup> This assertion fails on several grounds.

First, the petition misrepresents the established methodology and proposes a flawed methodology for finding seasonal costs that leads to a dramatic overstatement of these potential costs. Second, the “unexplained” costs are simply the institutional costs that have been studied, are understood, and are an integral part of the established

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<sup>22</sup> See, UPS Petition, Docket No. RM2020-9, May 29, 2020, at 23.

<sup>23</sup> Id. at 24.

methodology. Third, First-Class Mail has a much larger December volume peak than all competitive products combined, meaning that there is no logical basis for arguing that any “unexplained” December costs are solely caused by competitive products. If UPS’s “unexplained” December costs would be included in any incremental costs, they would have to be included in the incremental cost for a group of products that includes both First-Class Mail and competitive products. Finally, the proposed UPS methodology is incomplete and inconsistent. Applying it to all months leads to positive “unexplained” costs in months other than December (when the seasonal peak does not occur) and to negative “unexplained” costs in other months. UPS does not address, for example, if these latter negative cost changes should be used to reduce the incremental cost of competitive products.

1. UPS does not apply the established methodology in computing its “unexplained” costs and dramatically overstates them.

UPS calculates its “unexplained” costs in a multi-step process that it argues is based upon the costing models that comprise the established methodology.<sup>24</sup> However, as demonstrated in the report by Professor Bradley accompanying (and electronically attached to) these comments, the UPS method does not fulfill that promise and does not produce costs consistent with the established methodology.

UPS applies the same calculation method to categories of costs labeled as city and rural carriers, purchased transportation, clerks, and “other.” The “other” category is

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<sup>24</sup> Id. at 20 and Seasonal Increases in US Postal Service Costs Driven by Competitive Products, Presentation to Postal Regulatory Commission for Technical Conference, Sept. 29, 2020 at 11.

made up of the remaining cost segments, excluding a small number of components from cost segment 18.<sup>25</sup> For each type of cost, the UPS method first finds the annual unit costs for groups of products, such as First-Class Mail, Marketing Mail, Periodicals or all competitive products. The unit costs are calculated by taking the FY 2019 Cost Segment volume variable cost for the product grouping and dividing that by the sum of the product grouping's monthly volumes.

These calculated unit costs are then used to find the predicted change in monthly volume variable cost, by product. The predicted change in costs is found by multiplying each product grouping's unit cost by the change in its monthly volume. The predicted total change in each segment's cost is then the sum of the predicted change in costs for the various product groupings. What UPS calls the "unexplained" cost changes are measured as the differences between the accrued cost changes for the segment and the predicted cost change.

Examination of the mathematics underlying the UPS calculation reveals that it predicts monthly volume variable cost by multiplying a fixed annual unit cost by each month's associated volumes.<sup>26</sup> UPS indicates that this prediction represents the method used in the established methodology, but in reality, it does not. The established methodology works in the opposite direction. It takes the annual, or monthly, accrued cost for the cost segment and multiplies it by the relevant variability.

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<sup>25</sup> The UPS proposed method of calculation is explained in pages 20 to 25 of the UPS petition and pages 12 to 14 of the slides UPS presented at the technical conference.

<sup>26</sup> See, Report on Certain Aspects of UPS Proposal One, Docket No. RM2020-1, Dec. 15, 2020, at 11-13 (electronically attached to these Comments).

This difference in methods is important. Unlike the proposed UPS approach, the established methodology accounts for the fact that accrued costs increase in heavy volume months. This difference between the two methods causes the UPS method to materially understate peak volume variable costs. For example, as shown in Table 4, the UPS method predicts a \$21.3 million decline in combined city and rural volume variable costs for December 2018, whereas the established methodology projects a \$121.1 million increase.<sup>27</sup>

Table 4  
UPS Predicted and Established Volume Variable Cost Changes from November to December FY 2019

<b>Cost Segment</b>	<b>Trial Balance Cost Change</b>	<b>UPS Predicted VV Cost Change</b>	<b>Established VV Cost Change</b>
Clerks	\$185,859,827	\$89,461,116	\$152,477,934
City Carriers	\$155,920,327	-\$19,155,491	\$74,897,727
Rural Carriers	\$128,770,154	-\$2,124,613	\$46,200,552
Transportation	\$221,026,059	\$116,506,245	\$174,657,572
Sum	\$691,576,367	\$184,687,257	\$448,233,785

Of course, understating volume variable costs for December means that “unexplained” costs are overstated because the two sum to accrued cost. As Table 5

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<sup>27</sup> The program that calculates the predicted cost changes presented in Table 4 is presented in Folder USPS-RM2020-9-1.



shows, UPS's methodological error leads to unexplained costs that are often two to three times as large as a similar calculated value using the actual CRA methodology.<sup>28</sup>

Table 5  
UPS Predicted and Established "Unexplained" Changes Cost for  
December FY 2019

<b>Cost Segment</b>	<b>UPS "Unexplained" Cost Change</b>	<b>Established "Unexplained" Cost Change</b>
Clerks	\$96,398,711	\$33,381,893
City Carriers	\$175,075,817	\$81,022,600
Rural Carriers	\$130,894,767	\$82,569,601
Transportation	\$104,519,813	\$46,368,487
Sum	\$506,889,108	\$243,342,581

2. UPS's calculated costs are not "unexplained." They are simply a calculation of institutional costs for the month.

UPS repeatedly states that its calculated costs are unexplained or unaccounted for by the established cost models. This is false. The costs that UPS calculates are simply an estimate of the institutional costs for each function for the month being studied. As explained by Professor Bradley:<sup>29</sup>

Institutional costs are a well-established costing concept and include the costs associated with constructing and maintaining the Postal Service's various networks. They also include activities associated with the provision of all, or broad groupings of products that are not caused by individual products. Finally, they include infra-marginal costs

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<sup>28</sup> The program that calculates the cost changes presented in Table 5 is presented in Folder USPS-RM2020-9-1.

<sup>29</sup> See, Report on Certain Aspects of UPS Proposal One, Docket No. RM2020-1, Dec. 15, 2020, at 15.

which arise from economies of density and scale in the different Postal functions.

Any claim that institutional costs are unexplained is well out of step with modern costing methods.

Moreover, there is no reason that institutional costs need to be constant from month to month, as they are not necessarily fixed with respect to time. A material portion of institutional costs are variable costs that are associated with the provision of all products and would be expected to vary through time as need arises.

3. UPS's claim that any seasonal institutional costs are caused solely by competitive products ignores the facts about seasonal volume.

The UPS petition goes to some lengths to support its claim that all seasonal cost increases are caused by competitive products. It argues that First-Class Mail volume has been declining through time and thus conflates secular and seasonal volume movements. It produces "indexed" graphs in an attempt to somehow argue that competitive products' December volume increase exceeds that for First-Class Mail. Perhaps most telling is that it avoids presenting the straightforward evidence on the issue -- the actual volume increases for First-Class Mail and all competitive products mail in recent Decembers. These number alone eviscerate the petition's claim that "[t]he data, therefore, demonstrates that package volumes are responsible for the additional costs incurred by the Postal Service during peak season."<sup>30</sup>

Clearly, it is not solely competitive products that cause seasonal peak costs. It is true, as indicated in the UPS petition, that competitive products have a large percentage

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<sup>30</sup> See, UPS Petition, Docket No. RM2020-9, May 29, 2020, at 19.

increase in volume, but as demonstrated above, other products also have large percentage increases. In sum, whether one looks at absolute volume increases or percentage volume increase, there is simply no basis to claim that competitive products are the only volume materially increasing in December.

The fact that the volumes of a number of different groups of products experience December increases has important implications for any potential effort to include some, or all, of December's institutional cost in a product grouping's incremental cost. UPS wants to limit that exercise to the group of competitive products, but it is easy to see that its limited approach is incorrect. Any attribution of institutional costs should be made to the group of products that jointly cause the additional cost. That would include, at a minimum, both First-Class Mail and competitive products. In other words, if UPS's "unexplained" costs were to be included in the incremental cost for any group of products, that group would need to include First-Class Mail.

4. UPS ignores the implications of its proposed methodology for other months.

UPS emphasizes the allocation of costs that it claims are associated with competitive volume increases in December, but is silent on the implications of cost changes in other months. If a costing methodology is appropriate for December, then it should also be appropriate for other months. Something is wrong with a methodology if it is applicable to only a single month.

For example, if increases in competitive volumes cause additional "unexplained" costs in December, do the competitive volume declines in January cause a reduction in "unexplained" costs? In January 2019, competitive volumes fell. Table 6 presents the actual change in cost for the month along with UPS's prediction of the change in volume

variable and “unexplained” costs.<sup>31</sup> The predicted “unexplained” costs fell sharply, as competitive volumes fell by more in January than they increased in December.

According to the methodology presented in Proposal One, the “unexplained” cost reductions should be included in the incremental costs for competitive products for January. Following the proposed UPS approach would thus produce January cost declines that offset the December increases.

Table 6  
UPS Predicted and "Unexplained:" Cost Changes for January 2019

<b>Cost Segment</b>	<b>Trial Balance Cost Change</b>	<b>UPS Predicted VV Cost Change</b>	<b>UPS "Unexplained" Cost Change</b>
Clerks	-\$183,160,497	-\$128,833,476	-\$54,327,021
City Carriers	-\$177,985,760	-\$23,453,600	-\$154,532,161
Rural Carriers	-\$101,310,986	-\$23,313,045	-\$77,997,942
Transportation	-\$206,561,453	-\$142,718,459	-\$63,842,994

And what about months in which competitive volumes rise but “unexplained” costs fall? The existence of such months invalidates UPS’s claim that changes in competitive volumes are the sole cause of changes in “unexplained” costs. This is exactly what happened in April of 2019, during which the Postal Service experienced an increase in competitive products’ volume but, as Table 7 demonstrates, an

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<sup>31</sup> The program that calculates the cost changes in Table 6 is presented in Folder USPS-RM2020-9-1.

“unexplained” cost decline.<sup>32</sup> This result dramatically demonstrates the selectiveness and fragility of the UPS proposal.

Table 7  
UPS Predicted and "Unexplained" Cost Changes for April 2019

Cost Segment	Trial Balance Cost Change	UPS Predicted VV Cost Change	UPS "Unexplained" Cost Change
Clerks	-\$15,427,089	\$6,817,652	-\$22,244,742
City Carriers	-\$28,433,779	\$9,146,715	-\$37,508,493
Rural Carriers	-\$833,905	\$3,019,563	-\$3,853,469
Transportation	\$4,086,350	-\$1,562,624	\$5,648,974

**D. The UPS petition misunderstands how the established PRC/USPS costing methodology works. This leads it to misstate how that methodology handles seasonal costs.**

1. UPS incorrectly describes Postal Service costing models both in general and in specific terms.

The UPS petition presents an inaccurate history of postal costing: In its telling, because the “legacy” costing models were developed at a time when parcels composed a smaller portion of overall volume, the earlier-generation models accounted only for letters, with parcels being brought in as late “add-ons” to the models in the mid-2000s as package volumes grew.<sup>33</sup> Based on this inaccurate picture, the petition goes so far

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<sup>32</sup> The program that calculates the cost changes in Table 7 is presented in Folder USPS-RM2020-9-1.

<sup>33</sup> See, UPS Petition, Docket No. RM2020-9, May 29, 2020, at 1. See also, id. at 29.

as to say that “the entire system for allocating costs... is insufficient to properly attribute incremental costs of delivering packages today.”<sup>34</sup>

The falsity of this history can be easily demonstrated by referring to a single Commission rate case that took place thirty years ago and recorded that, even then, measuring the cost of parcels was an integral part of the established costing models. The following quotations are all from the Commission’s Opinion and Recommended Decision in Docket No. R90-1, but they also make reference to previous Commission opinions, showing the inclusion of parcel costing analyses as far back as 1981.

The UPS petition focuses on both city carrier costs and transportation costs as areas in which it claims parcel costing has been excluded and thus not appropriately included in the current cost models.<sup>35</sup> But review of the R90-1 decision shows that parcels were explicitly included in the analysis of costs in those areas. First, in the area of city carriers, the load time study (analyzing the time cost of city carrier activities at delivery stops) included parcels along with letters and flats:<sup>36</sup>

Estimating elemental load time variability is complex compared to estimating coverage-related load time variability. It requires volume data not just by subclass, but by shape (letters, flats, parcels, and accountables) as well as a count of collected mail. Data on stop type (SDR, MDR, BAM), delivery container type (loose mail, bundles, etc.), and receptacle type (mailbox, desk drop, etc.) are also gathered. (Emphasis added.)

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<sup>34</sup> Id. at 29.

<sup>35</sup> Id. at 29-35.

<sup>36</sup> See, Postal Rate Commission, Opinion and Recommended Decision, Docket No. R90-1 at III-58.

Moreover, the analysis of carrier parcel costs was not limited to just time at the stop, but also included a special parcel study analyzing the time associated with access to individual stops:<sup>37</sup>

Analyses conducted with data from two surveys performed on Special Purpose Routes in 1980-81 have provided the variability estimates and distribution keys for rate hearings from 1984 to the current docket. These surveys, the Support Route Cost Survey (SRCS) and **the Parcel Access Test** (PAT), are referred to as the CCS III. (Emphasis added.)

In fact, UPS was an active participant in the R90-1 case and provided testimony on the costing of parcels:<sup>38</sup>

Witness Nelson notes that the data Sharkey uses includes deliveries to postal facilities and asserts that such data elements should not be included in the regression analyses. Performing a regression analysis only on the deliveries to nonpostal facilities for **parcels and non-parcels**, Nelson estimates variability factors of 86.8% and 35.8% respectively. UPS-T-I at 32-33. (Emphasis added.)

The inclusion of parcels in the established costing models did not start in Docket No. R90-1. Earlier cases also included explicit measures of carrier parcel costs:<sup>39</sup>

For Docket No. R84-1, the Postal Service applied a multivariate regression to the SRCS load time data to produce variability estimates for **parcels**, accountables and other deliveries, and for collections. These results have been relied upon ever since that time. (Emphasis added.)

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<sup>37</sup> Id. at III-92.

<sup>38</sup> Id. at III-91.

<sup>39</sup> Id. at III-100.

Transportation is another area in which measuring parcel costs was explicitly included in the established costing model. One area that arose in Docket No. R90-1 was the construction of a new transportation volume measurement system, TRACS, which measured volumes for letters, flats and parcels:<sup>40</sup>

The parties are unanimous in their support for the use of TRACS for the transportation services included in it. Even parties whose transportation costs have increased greatly following the initiation of TRACS favor the use of its distribution keys. E.g., MPA Brief at 30. United Parcel Service (UPS), a competitor of the Postal Service, calls the system a major improvement. UPS Brief at 37.

One of the primary results from TRACS was identification of the sources of parcel costs:<sup>41</sup>

One of the main findings of TRACS is that in practice there are not two discrete surface transportation networks -- one for preferential mail (such as First Class) and a separate one for nonpreferential mail (such as **parcel post**). (Emphasis added.)

Finally, one of the most litigated issues in Docket No. R90-1 was measuring the cost of transporting parcels to Alaska:<sup>42</sup>

From the beginning of this proceeding, air transportation costs in Alaska have been a controversial issue. The issue involves the costs of air service for **parcel post** when that is the only means of transportation available to very remote communities. Some of these parcels are part of what is called the "bypass program."

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<sup>40</sup> Id. at III-155.

<sup>41</sup> Id. at III-157.

<sup>42</sup> Id. at III-194.



Review of the historical record unambiguously demonstrates that the established costing models have included parcels as an “equal partner” with letters and flats for decades. The claim put forth in the UPS petition about the models ignoring or excluding parcels is demonstrably false.

In addition, the UPS petition fails to acknowledge that the Postal Service actively pursues updating and refining the established costing models, as demonstrated in Table 8. The established costing models are neither old nor out-of-date. They have been developed through an open, adversarial process in which interested parties such as UPS have regularly contributed to the formation.

Table 8  
Cases Including Updates and Revisions to  
the Established Costing Models

<b>Transportation</b>	<b>City Carriers</b>
R80-1	R80-1
R84-1	R84-1
R87-1	R87-1
R97-1	R90-1
R2000-1	R94-1
RM2014-6	R97-1
RM2016-12	R2005-1
RM2021-1	RM2015-7
	PI2017-1
	RM2019-6
	RM2020-7

UPS also asserts that the established models assume package delivery activities are fully separable from regular delivery activities.<sup>43</sup> It is not clear what UPS means by

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<sup>43</sup> See, Seasonal Increases in US Postal Service Costs Driven by Competitive Products,

this assertion, but for its part, the Postal Service does not consider parcel delivery to be completely separate from letter and flat delivery. There are strong economies of scope associated with a single carrier delivering parcels along with letters and flats, as it would be inefficient to have two trucks (one for letters and flats and the other for parcels) covering a single route instead of just one. It is true that the *extra* time associated with delivering deviation parcels is separately measured in the route evaluation process, while in-receptacle parcel time is included with letter and flat delivery time:<sup>44</sup>

The route evaluation process is designed to produce information that is used to configure carriers' routes. To that end, it separately measures the time associated with those packages that cause the carrier to deviate from the normal process of delivery, because such packages are particularly important in calculating the time requirement for the route. In contrast, the time for packages that fit in the mail receptacle is included in regular delivery time, as their delivery is considered to be part of the regular delivery process.

Moreover, to explicitly capture the time associated with delivering parcels, the Postal Service did undertake a study to separately identify the additional delivery time caused by both types of parcels:<sup>45</sup>

While this approach is entirely appropriate for a route configuration analysis, it does not meet the needs of an attributable costing analysis. An attributable costing analysis requires capturing the time for both deviation packages and those packages that fit in the receptacle. This need is emphasized by the fact that there are more in-receptacle packages than there are deviation packages. Consequently, the time proportions based upon the Form 3999 data must

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Presentation to Postal Regulatory Commission for Technical Conference, Sept. 29, 2020 at 22.

<sup>44</sup> See, Report on City Carrier Street Time Study, USPS-RM2015-7/1, December 11, 2014 at 15.

<sup>45</sup> Id. at 15-16.

be adjusted to account for the fact that some of the time that the route evaluation process records for regular delivery is actually time associated with delivery of in-receptacle packages.

The adjustment will be made with data collected in the package and accountable field study described in Section IV, below. As part of that study, city carriers recorded the amount of time they spent delivering in-receptacle packages, deviation packages, and accountables. This total delivery time was compared to the total street time (for the same carriers on the same days) to calculate the proportion of total street time dedicated to package and accountable delivery.

Such a study does not preclude the existence of common time, in which parcels and other mail are jointly handled on a route. This common time is not caused by an individual product or group of products, and is thus not attributable cost because it would continue to exist if the individual product, or group of products, were not provided. Instead, the study focused on measuring the identifiable additional time caused by parcels and thus attributable to them. It is correct that the established methodology does not estimate the parcel *variabilities* jointly with the letter and flat variabilities. But parcel variabilities are separately estimated because of econometric challenges, not assumptions about the way parcels are handled:<sup>46</sup>

First, the volume of packages delivered is very small relative to the volumes of letters and flats delivered. A typical city route, on an average day, delivers about 2,300 letters and flats to about 600 delivery points. But that same typical route will deliver only 30 to 40 packages. This means that fewer than 5 percent of delivery points get a package on a typical day, and that packages represent under 2 percent of total delivered volume. Consequently, the delivery time for packages is an order of magnitude smaller than the delivery time for letters and flats, and the impact of package delivery on total delivery time can be overwhelmed by the impact of

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<sup>46</sup> Id. at 85.

letter and flat delivery. This makes it extremely difficult to estimate a package variability jointly with letter and flat variabilities. The volume of accountables is even smaller than the volume of packages, with a typical route delivering just a handful per day. Despite the fact that accountable delivery is time consuming, on a per-piece basis, it accounts for a tiny amount of total street time. Finally, packages are handled in different ways in delivery, depending upon their size, and this complicates the task of measuring a street time variability for packages. For these reasons, it is logical to pursue a separate analysis to measure the attributable costs of packages and accountables.

Moreover, the likely implication of separate variability estimation for parcels is that the marginal times and variabilities for parcels are overstated. That is because separate estimation of parcel variabilities does not allow for the estimation of negative cross-products associated with economies of scope. Finally, the Postal Service continues to research this issue by investigating whether there are econometric techniques that support accurate estimation of joint parcel variabilities.

UPS criticizes the established method of calculating incremental costs and argues that the Commission should require the Postal Service to modify the incremental cost model.<sup>47</sup> UPS argues that because the volume of packages has gotten so large that the working assumptions of the model are no longer valid.<sup>48</sup> No evidence is

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<sup>47</sup> See, UPS Petition, Docket No. RM2020-9, May 29, 2020, at 5 and Seasonal Increases in US Postal Service Costs Driven by Competitive Products, Presentation to Postal Regulatory Commission for Technical Conference, Sept. 29, 2020 at 32.

<sup>48</sup> See, Seasonal Increases in US Postal Service Costs Driven by Competitive Products, Presentation to Postal Regulatory Commission for Technical Conference, Sept. 29, 2020 at 33. In making this assertion UPS mixes products (like Priority Mail) with shapes (like letters and parcels). Because there is not a product called “parcels” or “packages,” the Postal Service does not calculate incremental costs for that aggregation. This point, in and of itself, invalidates UPS’s claim.

brought to support this claim, and in fact the volume of competitive products is still quite small. Table 9 presents the volumes for the various groupings of products for Fiscal Year 2019 and Fiscal Year 2020.<sup>49</sup> In the most recent normal fiscal year, 2019, all domestic competitive products combined make up just under 4 percent of total volume. This puts them in the range of Periodicals volume, which has always been considered a very small product group. Large volume products are illustrated by First-Class Mail Presort letters, which represents nearly twenty-five percent of total volume, or Marketing Mail letters, which represent nearly a third of total volume.

Table 9  
FY 2019 and FY2020 Volumes by Product Group

Product Group	FY 2019 Volume	Proportion	FY 2020 Volume	Proportion
First Class	54,943,276	38.5%	52,622,807	40.7%
Marketing Mail	75,690,048	53.1%	64,180,127	49.7%
Periodicals	4,634,618	3.3%	4,006,080	3.1%
Package Services	621,696	0.4%	570,806	0.4%
All Other Market Dominant Mail	318,687	0.2%	346,429	0.3%
<b>Total Domestic Competitive</b>	<b>5,506,760</b>	<b>3.9%</b>	<b>6,715,782</b>	<b>5.2%</b>
International Competitive	165,694	0.1%	412,548	0.3%
International Market Dominant	689,203	0.5%	316,711	0.2%
Total	142,569,982	100.0%	129,171,290	100.0%

Even in the aberrant Fiscal Year 2020, in which the COVID-19 pandemic and associated recession produced dramatic growth in packages and reduction in Marketing Mail, competitive products were still a small proportion of total volume. Despite double-digit growth in FY 2020, competitive products were just 5 percent of total volume for that fiscal year.

<sup>49</sup> The volumes included in Table 9 are presented in Folder USPS-RM2020-9-1

UPS also raises an invalid claim about the inapplicability of the established incremental cost model to calculating the incremental cost for competitive products. Yet, it fails to present any evidence to support its assertion and instead relies upon snippets of quotations by the Commission and the Postal Service. The presentation of these snippets is misleading, however, because the actual point being made by the Commission is in direct contradiction to the assertion that UPS is making. For example, UPS's first point is the claim that the volume of competitive products is so large that the constant elasticity methodology is not applicable.<sup>50</sup> To support this assertion, UPS cites the Commission's Order No. 3506 in Docket No. RM2016-2, presenting a quotation that appears to be the Commission criticizing the use of the constant elasticity method in the incremental cost model.<sup>51</sup>

However, in that order the Commission is actually criticizing the use of the constant elasticity method in UPS's proposed approach in that case. Contrary to UPS's edited quotation, the full quotation by the Commission makes very clear that the constant elasticity is appropriate for the incremental cost model, but not appropriate for UPS's proposed approach in that case. The Commission starts out by noting that UPS's Proposal One (in that case) requires evaluating the cost curve at very low volume to zero volumes, an area in which the Postal Service does not operate:<sup>52</sup>

The constant elasticity assumption is central to Proposal One and, while useful for plotting the curve of a cost function

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<sup>50</sup> See, Seasonal Increases in US Postal Service Costs Driven by Competitive Products, Presentation to Postal Regulatory Commission for Technical Conference, Sept. 29, 2020 at 32-35

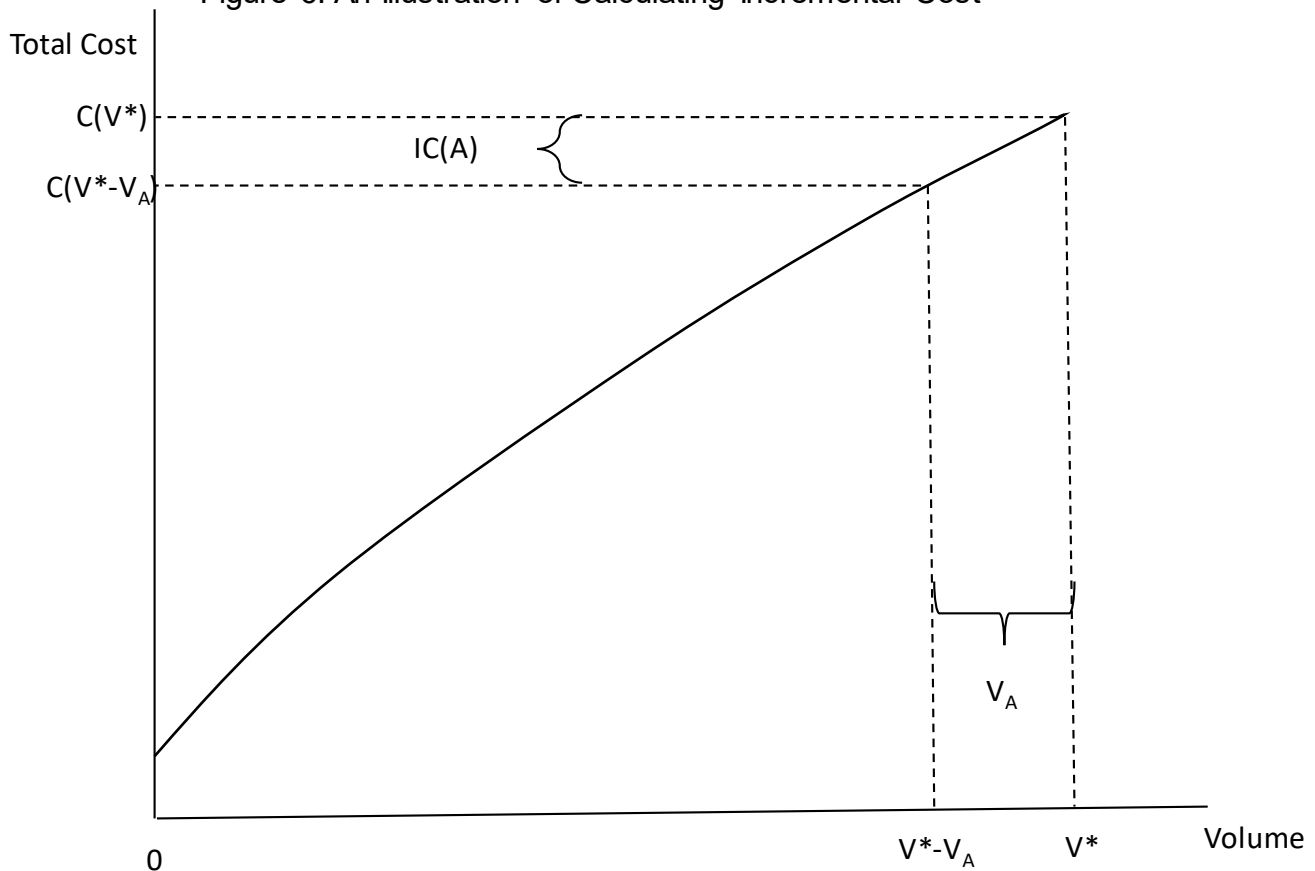
<sup>51</sup> Id. at 35.

<sup>52</sup> See, Postal Regulatory Commission, Order No. 3506, Docket No. RM2016-2, September 9, 2016 at 38.

across its entire cost driver, cannot be justified and, in some instances, requires other untenable assumptions. The constant elasticity assumption may inaccurately represent the shape of the cost curve at very low levels of volume. This assumption lacks an empirical basis, as the Postal Service has not experienced the levels of volume necessary to verify this assumption. Applying the constant elasticity assumption to levels of volume far beyond the range of actual experience produces results that are inadequately supported and unreliable. (Footnote omitted)

The incremental cost model does not require evaluation of the curve at low levels of volume because, for each product or group of products, one calculates the additional cost arising from adding that product, or group of products, to the existing vector of products. This is illustrated in Figure 6 which shows that the evaluation takes place at current volume levels. The figure illustrates the calculation in incremental cost for product “A,” showing the reduction in cost associated with the removal of product A’s volume from the vector of products. Note that the calculation takes place at current volume levels, not at, or near, zero volume levels.

Figure 6: An Illustration of Calculating Incremental Cost



The Commission recognized this key distinction in its order, clearly delineating between the use of the constant elasticity method in the incremental cost model versus its use in the UPS's Proposal One model:<sup>53</sup>

The model discussed above incorporates inframarginal costs as part of the calculation of incremental costs but is limited to the inframarginal costs that can be causally linked to a specific product. The amount of inframarginal costs can be calculated as the difference between the attributable cost and the incremental cost of a specific product.

<sup>53</sup> Id. at 42.



Like UPS's proposed method, this method uses a constant elasticity assumption to model cost components, but it avoids the issues facing UPS's proposed method by restricting itself to limited amounts of volume (*i.e.*, the volume of each product).<sup>54</sup> By calculating only the incremental inframarginal costs, the Postal Service's model only estimates inframarginal costs in a very small range of a component's cost curve where the constant elasticity assumption has been empirically verified based on observed volumes. The Postal Service does not attempt to calculate the inframarginal costs of an entire component. (Footnote in original).

The Commission also unambiguously separated UPS's proposed model from the established incremental cost model:<sup>55</sup>

In summary, UPS's proposed model assumes away any possible fixed costs for the components in which it calculates inframarginal costs and assumes a cost curve that cannot be empirically verified. The Postal Service's incremental cost model does neither.

It is difficult to understand how UPS can criticize the use of the constant elasticity method for a group of products that cover just four to five percent of total volume when it previously argued, in its own proposal, that the constant elasticity approach was an appropriate method to use when covering 100 percent of volume.

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<sup>54</sup> The Public Representative, on reply, supports this application of constant elasticity. PR Reply Comments at 15.

<sup>55</sup> See, Postal Regulatory Commission, Order No. 399, Docket No RM2010-4, January 27, 2010 at 43.

2. UPS fails to accurately describe the Postal Service's analysis of seasonal costs

UPS paints an uninformed, dated, and inaccurate picture of how the various Postal Service costing models attribute seasonal costs to products. It presents a laundry list of criticisms, most of which are inaccurate and none of which are material. The Postal Service is continuously updating and improving its costing models, and refining the treatment of peak costs is part of that process. There are no concerns raised by UPS that cannot be considered within the existing costing structure, and the criticisms either individual or combined do not justify UPS's call to jettison the established models.

UPS initially claims, without evidence, that studies based upon data during off-peak months are necessarily not applicable to peak months.<sup>56</sup> But such a claim is not necessarily true and depends upon the nature of the data collected and the Postal Service operational response to a volume increase. For example, it may be that the operation being studied is structural, in the sense that the analyzed time is associated with a physical action (like delivering letters, flats, and parcels) that is the same during the peak and off-peak periods.

In addition, if the collected data are cross-sectional or have a large cross-sectional component, then they may well be applicable to other months in the year. The applicability exists because the estimated variabilities depend upon the variations in volumes and costs across operational units, not variations across periods of time. It is quite possible that the volume variations between very small and very large units are greater than the variations between off-peak and peak months. In this circumstance,

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<sup>56</sup> See, UPS Petition, Docket No. RM2020-9, May 29, 2020, at 3.

the cross-sectional analysis includes experience at peak volumes and the estimated coefficients are likely to be applicable to peak months.

Moreover, in some instances the Postal Service responds to seasonal volumes by continuing to use the existing technology and methods, and just applying more of the same resources. In this situation, a structural model estimated during an off-peak period would be directly applicable to the peak season. This is not to say that there are not instances when it is appropriate to separately investigate peak season costs. If the increased volume stimulates higher productivities, then marginal costs decline during the peak season, and this response should be included in the costing models. In other instances, separate resources may be procured for the peak season in a manner different from the procurement of resources during the peak season. If this occurs, the Postal Service should, and does, separately investigate peak season costs. In sum, UPS's blanket condemnation of structural models estimated with off-peak data is inappropriate, and a determination of whether a separate peak-season analysis is appropriate should be made on a case-by-case basis.

For example, when updating the cost attribution analysis for special purpose route carriers, the Postal Service determined that the duties and methods of city carriers participating in special purpose activities likely changed during the peak season.<sup>57</sup> This operational change included higher density delivery action within established SPR units and the addition of SPR runs for parcels in delivery areas that did not have any SPR

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<sup>57</sup> See, Docket No. RM2019-6, A New Study of Special Purpose Route Carrier Costs, Professor Michael D. Bradley, June 21, 2020, at 66-67.

runs in the off-peak season.<sup>58</sup> The Postal Service thus collected data during the seasonal peak and estimated separate models for that period. Because the underlying parameters were likely different during the peak, investigating a separate model was appropriate.

In contrast, a separate analysis is not required for air transportation. The Postal Service simply acquires more air transportation during the peak, and those additional costs are included in the Postal Service transportation model. But, because the operations and methods of acquiring transportation are the same as during the off-peak period, a separate cost analysis is not required.

City carrier letter route costs fall in between these two cases. City carrier letter route costs rise modestly in December but the cost per city carrier hour stays about the same. City carrier letter route operations do not change dramatically during the peak volume period as carriers primarily continue to work their regular routes, with some assistance from SPR carriers to deliver additional parcel volumes. To investigate the possibility that the cost response to volume is different in December, the Postal Service is pursuing a separate econometric analysis of city carrier letter route costs. Such an analysis will determine whether letter route operations are uniform throughout the year.

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<sup>58</sup> UPS is simply in error when it claims that the recent SPR study was limited to just locations with SPR units and thus does not include non-variable SPR costs. See, UPS Petition, Docket No. RM2020-9, May 29, 2020, at 36, footnote 63. As was explained in the SPR report, the study incorporated all SPR costs, whether they occurred at regular SPR units or were just added to provide some supplemental parcel delivery hours in December. To the extent the addition of SPR runs for the seasonal peak occurred, both volume variable and non-volume variable costs were included in the analysis. Of course, SPR costs cannot be measured where they have not been incurred, but all accrued SPR costs were included in the study.

UPS also criticizes the established purchased highway transportation models because they apply the regular cost-to-capacity variabilities to the separate Christmas account. It is true that this approach had been followed, primarily because until recently Christmas account costs were too small to justify launching a separate study. As Christmas account costs have risen, the Postal Service has responded and recently completed a study which separately measures cost-to capacity variabilities for those accounts.<sup>59</sup> This effort moots UPS's criticism. UPS also criticizes the Postal Service for not including Christmas routes in its TRACS volume measurement system.<sup>60</sup> Again, Christmas routes were not included because, in the past, there were too few of such routes to support accurate statistical sampling. As the amount of Christmas transportation has grown, the Postal Service has responded and is currently investigating the feasibility of separately testing Christmas routes in TRACS.

Finally, UPS criticizes the established models for not incorporating what it calls temporary peak-season costs associated with the Postal Service's response to peak volumes.<sup>61</sup> Such a claim reveals a misunderstanding of the established models. UPS says the models should account for responses like the opening of temporary annexes, the incurrence of overtime wages, or the sending of carriers on supplemental parcel runs.<sup>62</sup> But that is exactly what the models do. The established models separately

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<sup>59</sup> See, Docket No. RM2021-1, Proposal Seven, November 9, 2020, at 2-3.

<sup>60</sup> See, UPS Petition, Docket No. RM2020-9, May 29, 2020, at 35.

<sup>61</sup> Id. at 36.

<sup>62</sup> Id. at 2.

identify the costs of seasonal annexes and attribute those costs to parcels.<sup>63</sup> The accrued costs incorporated in the models embody any overtime costs, although such costs do not increase hourly labor costs.<sup>64</sup> And, the SPR model expressly incorporates seasonal runs to deliver the additional parcels occurring during the peak.<sup>65</sup>

3. UPS proposes an erroneous and inaccurate method for calculating seasonal incremental costs

Based upon the various mistakes documented above, UPS proposes that all seasonal costs be incorporated, as a lump sum, into the incremental cost of competitive products without regard to causality or the relationship between volumes and cost.<sup>66</sup> This crude effort at increasing competitive product costs is inconsistent with appropriate costing practice, does not reflect operational reality, and would produce inaccurate and distorted product costs. It would imply abandoning the sound costing principles developed by the Commission through years of study of postal costs. It would make the calculation of seasonal attributable costs inconsistent with the calculation of non-seasonal attributable costs, and would replace causality as a basis for costing with arbitrary allocation.<sup>67</sup> Without a causal basis, the choice of which product will receive the

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<sup>63</sup> See, Docket No. RM2020-1, Order No. 5637 at 9.

<sup>64</sup> See, Response of The United States Postal Service to Order No. 5697 Regarding Overtime Costs, Docket No. RM2020-10, Nov. 24, 2020, at 1-2.

<sup>65</sup> See, Docket No. RM2019-6, A New Study of Special Purpose Route Carrier Costs, Professor Michael D. Bradley, June 21, 2020, at 66.

<sup>66</sup> See, UPS Petition, Docket No. RM2020-9, May 29, 2020, at 3.

<sup>67</sup> For a mathematical demonstration of the flaws of UPS's proposed approach, see, Report on Certain Aspects of UPS Proposal One, Docket No. RM2020-1, Dec. 15, 2020, at 11-13 and the Mathematical Appendix.

allocation of costs becomes arbitrary. Within UPS's proposed approach, one could justifiably replace its proposed allocation of seasonal peak costs to competitive products with the allocation of those seasonal peak costs to First-Class Mail. Because there is no causal, operational, or empirical basis for the approach, the choice would be solely a matter of personal preference.

**E. UPS's proposed "short cut" approach to calculating seasonal incremental cost is also fatally flawed**

Perhaps realizing the infeasibility of its proposed approach to calculating seasonal incremental costs, UPS also proposes a short-cut approach that would not require massive restructuring of the established methodology.<sup>68</sup> The short-cut approach involves two steps. First, UPS would have the Commission use its flawed proposal, the "unexplained" cost method, to calculate a total seasonal cost amount that it would arbitrarily assign to the group of competitive products. This would increase the incremental cost of the group. Second, UPS proposes using some arbitrary method of *pro rata* allocation to assign the lump of "seasonal cost" to individual competitive products' incremental costs.

Both steps of this shortcut approach are filled with errors. As demonstrated above, UPS's approach to what it calls unexplained costs does not reflect the structure of the established models and overstates "unexplained" costs. In addition, those costs are simply the non-volume variable costs that occur during the peak season and, as is the case during the rest of the year, only the relevant inframarginal part of these costs

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<sup>68</sup> See, UPS Petition, Docket No. RM2020-9, May 29, 2020, at 40.

should be included in the incremental cost for competitive products. The UPS shortcut method does not produce a reliable incremental cost for the group of products.

Even if it did, it would be an error to arbitrarily allocate the incremental costs of the group to the individual products within that group, so the second step of UPS's approach must also be disregarded. Because the Postal Service experiences economies of scope, scale, and density, the incremental cost of a group of products does not equal the sum of the incremental costs of members of that group. Thus, UPS's proposed allocation is inaccurate. It is also arbitrary, as there is no causal basis for choosing the method for the pro rata calculation. It could be based upon the products' relative volume, their relative weight, their relative cube, their relative volume variable cost or any other measure an analyst chose to employ. The lack of a unique answer for the allocation reflects its inherent arbitrariness and inaccuracy.

In sum, the UPS shortcut proposal contains numerous errors, does not produce unique or reliable incremental cost, and is not consistent with sound and accepted costing principles. It provides nothing of value for improving product costing and must be rejected.

## **F. Conclusion**

The Commission's standard for approving costing proposals is to determine if they improve the quality, accuracy, and completeness of cost attribution. Proposal One fails on all three grounds. The proposal is riddled with conceptual and analytical errors. It would reject the causal basis for linking seasonal costs to products and would replace it with an arbitrary, non-unique, *ad hoc* method. The petition misstates the nature of



seasonal volume increases and fails to acknowledge the efforts made by both the Postal Service and the Commission to appropriately attribute those costs to the products that cause them. Proposal One advocates the arbitrary allocation of irrelevant volume variable and non-variable costs to competitive products and recommends the Commission abandon well established costing principles. For these reasons, the Postal Service respectfully recommends that the Commission deny its adoption.

Respectfully submitted,

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